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No.

In The

# Supreme Court of the United States

October Term, 1997

**SPARTAN MILLS,**

*Petitioner,*

*vs.*

**BANK OF AMERICA ILLINOIS,**

*Respondent.*

*On Petition for Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit*

## PETITION FOR WRIT OF CERTIORARI

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75 pp

## QUESTIONS PRESENTED

I. If a bankruptcy court, without a summons and complaint being filed and served, enters an order determining an issue that Rules 7001 *et seq.* of the Federal Rules of Bankruptcy Procedure provide may be determined only by the filing and serving of a summons and complaint, is that order to be given *res judicata* effect on that issue?

II. Does a bankruptcy court have jurisdiction to enter an order determining the priority of liens in proceeds of the sale of property of the estate, when such liens exceed the amount of the proceeds and the lien-priority determination would have no effect on the estate or on creditors other than the creditors holding liens?

III. If an order is entered by a bankruptcy court without jurisdiction properly being established, is the order subject to collateral attack in another court?

## LIST OF PARTIES

The caption of this case contains the names of all the parties to this proceeding. Petitioner, Spartan Mills, does not have a parent company or a non-wholly-owned subsidiary.

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## PETITION FOR WRIT OF CERTIORARI

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Petitioner, Spartan Mills ("Spartan"), respectfully petitions for writ of certiorari to review the judgment of the Unites States Court of Appeals for the Fourth Circuit.

## OPINIONS BELOW

The opinion of the Court of Appeals is reported at 112 F.3d 1251 and is reproduced in the Appendix filed herewith ("App.") at App. A, 1a. The order of the Court of Appeals

denying Spartan's petition for rehearing and rehearing in banc is reproduced at App. C, unreported opinion of the district court in this reproduced at App. B, 13a.

## STATEMENT OF JURISDICTION

The opinion of the Court of Appeals from which this review is sought was entered on May 6, 1997. The Court of Appeals entered its order denying the petition for rehearing on June 2, 1997. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

## STATUTES INVOLVED

The pertinent parts of the Federal Rules of Bankruptcy Procedure, the Federal Rules of Civil Procedure, and of South Carolina Code §§ 29-15-70 and 36-9-310 are set forth below:

Rule 7001 F.R. Bankr. P.
Scope of Rules of Part VII

An adversary proceeding is governed by the rules of this Part VII. It is a proceeding: * * * (2) to determine the validity, priority, or extent of a lien or other interest in property other than a proceeding under Rule 4003(d); * * *. (The full text of this rule is reproduced at App. D, 25a.)

Rule 7003 F.R. Bankr. P.
Commencement of Adversary Proceeding

Rule 3 F.R.Civ.P. applies in adversary proceedings.

Rule 3 F.R. Civ. P.
Commencement of Action

A civil action is commenced by filing a complaint with the court.

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Rule 7004 F.R. Bankr. P.
Process; Service of Summons, Complaint

(a) Summons; Service; Proof of Service. Rule 4(a), (b), (c)(1), (d)(1), (e)-(j), (l), and (m) F.R.Civ.P. applies in adversary proceedings. * * *. (The full text of this rule is reproduced at App. D, 25a.)

Rule 4 F.R. Civ. P.
Summons

(a) Form. The summons shall be signed by the clerk, bear the seal of the court, identify the court and the parties, be directed to the defendant, and state the name and address of the plaintiff's attorney or, if unrepresented, of the plaintiff. It shall also state the time within which the defendant must appear and defend, and notify the defendant that failure to do so will result in a judgement by default against the defendant for the relief demanded in the complaint. * * *

(b) Issuance. Upon or after filing the complaint, the plaintiff may present a summons to the clerk for signature and seal. If the summons is in proper form, the clerk shall sign, seal, and issue it to the plaintiff for service on the defendant. * * *

(c) Service with Complaint; by Whom Made.

(1) A summons shall be served together with a copy of the complaint. The plaintiff is responsible for service of a summons and complaint within the time allowed under subdivision (m) and shall furnish the person effecting service with the necessary copies of the summons and complaint. (The full text of this rule is reproduced at App. D, 30a.)

S.C. Code § 29-15-70

A lien on account of work, labor and materials furnished in manufacturing, finishing, bleaching, mercerizing, dyeing and printing or otherwise processing natural or man-made fibers or goods of which natural or man-made fibers form a component part, as against goods in the lienor's possession, shall extend to any unpaid balance of account for work, labor and materials furnished in the course of any such process in respect of any other such goods of the same owner whereof the lienor's possession has terminated.

S.C. Code § 36-9-310

When a person in the ordinary course of his business furnishes services or materials with respect to goods subject to a security interest, a lien upon goods in the possession of such person given by statute or rule of law for such materials or services takes priority over a perfected security interest unless the lien is statutory and the statute expressly provides otherwise.

## STATEMENT OF THE CASE

Spartan appeared as a creditor in the bankruptcy case of Dash Industries, Inc. ("Dash"), that was pending in the United States Bankruptcy Court for the Southern District of Florida (the "Bankruptcy Court"). Pursuant to South Carolina statute, S.C. Code § 29-15-70, Spartan held a possessory lien in the amount of $633,090 on certain textile goods and on patterns and metal screens (used to process the textile goods) that were owned by Dash and were in Spartan's possession. Pursuant to S.C. Code § 36-9-310, Spartan Mills' possessory lien is superior to any security interest, even if such security interest were perfected prior to creation of the possessory lien.

Pursuant to a motion by the predecessor bank to the Respondent, Bank of America Illinois ("BAI"), the Bankruptcy

Court entered an Order Authorizing Debtor-In-Possession to Borrow Post-Petition, Restricting Use of Cash Collateral and Providing Adequate Protection (the "DIP Financing Order") on June 11, 1993. The DIP Financing Order was entered without service of summons and complaint on Spartan. The DIP Financing Order did not expressly address Spartan's lien, and Spartan contends that the DIP Financing Order did not have the effect of granting BAI's security interest priority over prepetition liens; BAI asserted that the DIP Financing Order so provided and the courts below in this collateral action so held. However, even if the DIP Financing Order provided as BAI asserted, the Bankruptcy Court was without jurisdiction over Spartan and its lien to enter the order.

On August 23, 1993, the examiner appointed in Dash's bankruptcy case filed a notice of an auction sale of the assets of Dash's estate, with the sale to be held on August 30, 1993. The notice stated that the sale of the assets was to be free and clear of liens, with such liens to attach to the proceeds of the sale. On August 23, 1993, the attorney for Dash filed a motion for approval of an auction sale of the assets of Dash's estate. The motion stated that the sale of the assets was to be free and clear of liens, with such liens to attach to the proceeds of the sale. On August 24, 1993, the Bankruptcy Court entered an order that, *inter alia*, set August 30, 1993, as the date for an auction sale of Dash's assets and provided that such sale would be free and clear of liens, with liens attaching to the proceeds. This motion, notice, and order made no mention of paying the proceeds of the sale to BAI.

On September 2, 1993, the Bankruptcy Court entered an order that approved the auction sale held on August 30, 1993, provided for the payment and holding in escrow of the auction proceeds, and set a deadline of September 15, 1993, for objections to approval of the sale of the assets to the high bidder. This order's text was silent as to the distribution of the proceeds, but the order's caption provided that the sale was free and clear of liens, with liens to attach to the proceeds.

On September 18, 1993, BAI's attorney sent to Dash's attorney a draft of an order captioned "Order Approving Debtor's Sale of Assets to Cone Mills Free and Clear of Liens, with Liens to Attach to Proceeds". Dash's attorney sent this draft order to Spartan's attorney on September 20, 1993. This draft order provided in paragraph 29 for the holding of the proceeds of the sale in escrow pending further order of the Bankruptcy Court, and it made no mention of paying the proceeds of the sale to BAI. On September 24, 1993, the Bankruptcy Court entered an order captioned "Order Approving Debtor's Sale of Assets to Cone Mills Free and Clear of Liens, with Liens to Attach to Proceeds" (the "Sale Order"). The Sale Order was virtually identical to the draft order, with the notable exception that paragraph 30, which corresponds to paragraph 29 in the draft order, now provided for the payment to BAI of that portion of the sales proceeds encumbered by its lien.

Thus, the Sale Order's caption "with Liens to Attach to Proceeds" was misleading in that the Sale Order actually provided for the distribution of the proceeds to BAI.

The Sale Order certificate of service (the "Certificate") shows service on Spartan by mail on September 27, 1993. The Certificate shows that the Sale Order was ***not*** served on Spartan's attorneys, and Spartan's attorneys did not receive a copy of the Sale Order pursuant to the mailing set out in the Certificate. The attorneys for Spartan did not receive a copy of the Sale Order until October 18, 1993.

At least as early as October 14, 1993, BAI had been put on notice that Spartan was asserting a possessory lien on the patterns and screens in its possession. Prior to that notice, Spartan had received a letter from Dash on or about January 10, 1990, requesting on behalf of BAI that Spartan subordinate its liens on Dash's inventory in Spartan's possession. Spartan refused to provide such subordination.

Pursuant to an agreement between Spartan and BAI, Spartan agreed to relinquish possession of the textiles, screens, and patterns to the purchaser to allow the sale to go forward, and BAI agreed that, for the purpose of determining Spartan's lien rights in the property in its possession, Spartan was deemed to have not relinquished possession of such property. Subsequent to this agreement, BAI was paid the sum of $781,075 from the proceeds of the sale of Dash's assets.

By order entered on September 20, 1993, Dash's bankruptcy case was converted from a Chapter 11 case to a Chapter 7 case effective October 1, 1993. At no time did Spartan intentionally waive its statutory lien rights in Dash's goods that were in Spartan's possession.

Spartan subsequently brought an action in the United States District Court for the District of South Carolina (the "District Court") for (1) a declaratory judgment that Spartan's lien is superior to BAI's security interests and that BAI converted the proceeds of the property subject to Spartan's lien and (2) a judgment in conversion to recover from BAI the value of the proceeds of the property that was in Spartan's possession, up to the amount of Spartan's claim, plus interest. The District Court's jurisdiction over this case was founded upon diversity of citizenship pursuant to 28 U.S.C. § 1332.

Following oral argument on cross motions for summary judgment, the District Court granted BAI's motion and denied Spartan's motion. In its order, the District Court stated that established Fourth Circuit authority required commencement of an adversary proceeding (with service of summons and complaint) in a bankruptcy court in order to extinguish Spartan's lien, and stated that the Bankruptcy Court apparently erred in ordering the proceeds be paid to BAI. Nonetheless, the District Court believed the opinion of this Court in *Celotex Corp. v. Edwards*, 514 U.S. 300, 115 S.Ct. 1493, 131 L.Ed.2d 403 (1995) overruled or limited this Fourth Circuit authority and precluded collateral attack on the DIP Financing Order and

on the Sale Order even though these orders, purportedly depriving Spartan of the priority of its lien and of the proceeds of the assets to which the lien attached, did not result from an action commenced with service of summons and complaint. Accordingly, the District Court entered summary judgment for BAI (App. B, 13a).

Spartan timely appealed to the Fourth Circuit Court of Appeals, which affirmed the District Court. The Fourth Circuit noted the principal of *Celotex* that an attack on an order may not be made collaterally unless it is based on the original court's lack of jurisdiction. 112 F.3d at 1255 (App. A, 6a). The Fourth Circuit found that the Bankruptcy Court had subject matter jurisdiction over all of Dash's assets and any lien contest in respect to them, 112 F.3d at 1256 (App. A, 8a), and it concluded that Spartan had received sufficient due process in the Bankruptcy Court for that court to have determined the priority of Spartan's lien relative to BAI's security interests. 112 F.3d at 1257 (App. A, 11a).

## REASONS FOR GRANTING THE WRIT

This Court should grant the writ in order to resolve a split between the federal circuit courts of appeal on the important question of whether *res judicata* effect is to be given to orders of a bankruptcy court affecting creditors' rights in property of the estate that are entered without the court's properly establishing jurisdiction over a person or over the subject matter purportedly being adjudicated. With regard to this important federal question, the highest court of the state of Nebraska has also adopted the position urged herein by Spartan but rejected by the Fourth Circuit in the opinion from which this petition arises.

Interpretations of this Court's ruling in *Celotex* that expand that decision beyond its intended scope and prevent collateral attack on orders entered without jurisdiction being established, as happened in the Fourth Circuit opinion from

which this petition arises, may exacerbate the split among the circuits on this issue.

In *Matter of Howard*, 972 F.2d 639, 641 (5th Cir. 1992), the court held that "[t]he general applicability of *res judicata* to bankruptcy plan confirmations must give way, however, to the interest of the secured creditor" when the creditor is not given statutorily required notice.

The highest court of the state of Nebraska has agreed with the Fifth Circuit. In *Antelope Cty. Farmers v. Citizens St. Bank*, 240 Neb. 760, 484 N.W.2d 822, 823 (1992), the court held that a bankruptcy court, lacking the authority in a plan confirmation order to determine lien rights in proceeds of the sale of the debtor's assets, had thus exercised jurisdiction without first establishing its jurisdiction, and the Nebraska Supreme Court held that the order was not *res judicata*. In these and other decisions by Circuit Courts of Appeal, a collateral attack on an order that exceeded the bankruptcy court's jurisdiction was permitted in a different forum.

Prior to the Fourth Circuit's decision from which this petition arises, that court's opinion in *Cen-Pen Corporation v. Hanson*, 58 F.3d 89 (4th Cir. 1995), firmly placed the Fourth Circuit in the camp that did not give *res judicata* effect to orders of a bankruptcy court that purportedly determined a creditor's lien rights in property of the estate without properly obtaining jurisdiction over the creditor and its lien. However, the Fourth Circuit held below that *Celotex* requires *res judicata* effect be given to the orders of the Bankruptcy Court with regard to Spartan's lien even though the Bankruptcy Court had not taken the proper procedural steps to establish its jurisdiction over Spartan's lien. 112 F.3d at 1256 (App. A, 10a).

## I.

**If a bankruptcy court, without a summons and complaint being filed and served, enters an order**

**determining an issue that Rules 7001 *et seq.* of the Federal Rules of Bankruptcy Procedure provide may be determined only by the filing and serving of a summons and complaint, the order is void and without *res judicata* effect on that issue.**

In the opinion from which this petition arises, the Fourth Circuit held:

> "Under the holding of *Celotex*, Spartan Mills cannot allow a final order that deprives it of a lien position to stand and then hope to attack it collaterally at another time and in another forum." 112 F.3d at 1256 (App. A, 10a).

The Fourth Circuit thus accorded *res judicata* effect with regard to Spartan's lien to the Sale Order and the DIP Financing Order entered by the Bankruptcy Court, even though these orders were entered without the Bankruptcy Court's obtaining jurisdiction over Spartan's lien.

**A. Jurisdiction is the *sine quae non* in *Celotex*.** In *Celotex*, a bankruptcy court had issued an injunction prohibiting judgment creditors from proceeding against supersedeas bonds that had been posted by bonding companies at the instance of the bankruptcy debtor. A judgment creditor brought an action in a different court to execute on his bond, and the creditor argued that the bankruptcy court did not have jurisdiction to have issued the injunction. This Court decided that the bankruptcy court had jurisdiction to issue the injunction, and thus the injunction was accorded *res judicata* effect. In *Celotex*, this Court began its opinion with a discussion of whether the bankruptcy court had jurisdiction to enter the injunction and made it clear that jurisdiction was a necessary predicate to the validity of the injunction:

> "In *GTE Sylvania, Inc. v. Consumers Union of United States, Inc.*, 445 U.S. 375, 386, 100

> S.Ct. 1194, 1201, 63 L.Ed.2d 467 (1980), we reaffirmed the well established rule that 'persons subject to an injunctive order issued by a court ***with jurisdiction*** are expected to obey that decree until it is modified or reversed, even if they have proper grounds to object to the order." 115 S.Ct. at 1498 (emphasis added).

Virtually the entire opinion in *Celotex* was devoted to reaching a determination that the bankruptcy court had jurisdiction to enter the injunction in question. Accordingly, a bankruptcy court must have established jurisdiction over the parties and the subject matter for its orders to have *res judicata* effect.

**B. Service of summons and complaint is necessary to establish jurisdiction to determine the validity, priority, or extent of a lien.** Prior to the opinion from which this petition arises, the Fourth Circuit, as held in *Cen-Pen,* required service of summons and complaint as a due-process requirement for a bankruptcy court to have jurisdiction to determine the validity, priority, or extent of a creditor's lien. In that case, the debtors attempted to determine the validity of a bank's lien on the debtors' real property through confirmation of a Chapter 13 plan following notice to creditors, including notice to the bank. The Fourth Circuit reversed the district court and found service of summons and complaint to be a prerequisite to determining the validity, priority, or extent of a lien:

> "Here the [debtors] did not take a sufficient 'affirmative step' to avoid [the bank]'s liens. ***Bankruptcy Rule 7001(2) expressly requires initiation of an adversary proceeding*** 'to determine the validity, priority, or extent of a lien or other interest in property,' with one exception not applicable here. The procedural requirements of such an action, which include,

> *inter alia*, the filing of a complaint and service of a summons, are set out in the Bankruptcy Rules. Bankruptcy Rule 7004, for instance, governs the procedures for service of process in adversary proceedings. *See In re Linkous*, 990 F.2d 160, 162 (4th Cir. 1993) * * *.
>
> "The [debtors'] reliance on § 1327 fails to appreciate the import of these Rules. ***Because confirmation of a Chapter 13 plan is res judicata only as to issues that can be raised in the less formal procedure for contested matters, confirmation generally cannot have preclusive effect as to the validity of a lien, which must be resolved in an adversary proceeding.*** * * *
>
> "***Initiation of an adversary proceeding is a prerequisite to challenging 'the validity or existence' of a lien against property of the estate*** * * *. Where such a proceeding 'is required to resolve the disputed rights of third parties, the potential defendant has the right to expect that the proper procedures will be followed.'" 58 F.3d at 93 (some citations omitted; first emphasis in original, other emphasis added).

This holding is rooted not only in the literal mandate of Rules 7001, 7003, and 7004 of the Federal Rules of Bankruptcy Procedure ("FRBP"), but also in constitutional principals. In *In re Linkous*, 990 F.2d 160 (4th Cir. 1993), a case relied on in the *Cen-Pen* opinion, the Fourth Circuit held that an order confirming a Chapter 11 plan of reorganization, which plan valued the collateral securing a creditor's lien, could not be given *res judicata* effect against the creditor, because it resulted in a denial of due process in violation of the

Fifth Amendment to the United States Constitution. 990 F.2d at 162. The court stated that:

> "'[a]n ***elementary and fundamental requirement of due process in any proceeding which is to be accorded finality*** is notice reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections.' *Mullane v. Central Hanover Bank & Trust*, 339 U.S. 306, 314, 70 S.Ct. 652, 657, 94 L.Ed. 865 (1950)." 990 F.2d at 162 (emphasis added).

In *Mullane*, this Court found constitutionally deficient a notice by publication by a bank to beneficiaries of a trust administered by the bank, when the bank knew the names and addresses of the beneficiaries. This Court stated that "when notice is a person's due, process which is a mere gesture is not due process." 339 U.S. at 315, 70 S.Ct. at 657.

In a later opinion also concerning a case under the Bankruptcy Act, this Court invalidated the denial of property liens held by the City of New York. *City of New York v. New York, N.H. & H.R. Co.*, 344 U.S. 293, 73 S. Ct. 299, 97 L.Ed. 333 (1953). The Bankruptcy Act required "reasonable notice" of the deadline for filing claims, but notice was given to the City of New York only by publication, even though the City was known by the bankrupt railroad to be a creditor holding liens. This Court rejected the bankrupt's argument that actual knowledge of bankruptcy put a duty of further inquiry on creditors and held:

> "[E]ven creditors who have knowledge of a reorganization have a right to assume that the ***statutory 'reasonable notice'*** will be given them before their claims are forever barred. * * *

> The ***statutory command for notice*** embodies a basic principle of justice--that a reasonable opportunity to be heard must precede judicial denial of a party's claimed rights." 344 U.S. at 297, 73 S.Ct. at 301 (emphasis added).

With regard to the determination of the validity or priority of liens, Congress has determined by FRBP Rules 7001, 7003, and 7004 that "reasonable notice" is service of summons and complaint. Thus, under the present Bankruptcy Code, the "statutory command for notice" concerning liens is service of summons and complaint. However, in the present case, the Fourth Circuit, apparently incorrectly influenced by the opinion in *Celotex*, has erroneously concluded that "the statutory command for notice" is no longer a command.

**C. A bankruptcy court may have jurisdiction for some purposes but not for others.** The Fourth Circuit's misconception with regard to whether the Bankruptcy Court had jurisdiction over Spartan and its lien for the purpose of determining the validity, priority, or extent of Spartan's lien may have been caused by the unique nature of proceedings in bankruptcy courts, wherein some issues are determined solely through service of summons and complaint under FRBP Rules 7001 *et seq.* and other issues are determined through notice and hearing under FRBP Rules 9014 *et seq.*, whereas other courts always commence an action with service of a summons and complaint. In its opinion, the Fourth Circuit summarily states:

> "We have little difficulty in concluding that the Florida bankruptcy court had subject matter jurisdiction over all of Dash Industries' assets and any lien contest in respect to them." 112 F.3d at 1256 (App. A, 8a).

Although some matters in bankruptcy courts may be disposed of by notice and hearing, the statutory command of FRBP Rules 7001, 7003, and 7004 makes clear that service of

summons and complaint is an absolute necessity to establish jurisdiction over the party for the purpose of determining the validity, priority, or extent of a lien. The Bankruptcy Court could, as it did, sell the assets of the bankruptcy estate by a procedure of mere notice to creditors and a hearing. Such a sale is permitted by 11 U.S.C. § 363, and the notice procedure is expressly sanctioned by FRBP Rule 6004 and implicitly sanctioned by the omission of asset sales from the list of actions in FRBP Rule 7001 that require commencement of an adversary proceeding. The Bankruptcy Court ***in general*** had jurisdiction over any lien contest concerning the assets and ***could*** have determined the priority of Spartan's lien; however, the Bankruptcy Court, in failing to follow the proper procedure, did not obtain jurisdiction over Spartan and its lien for the purpose of determining the lien's validity or priority.

Spartan clearly could not have successfully commenced the present case by filing a complaint in the United States District Court for the District of South Carolina and then mailing a copy of the complaint to BAI with a letter stating that Spartan will seek a default if an answer is not filed in 30 days. Absent service of summons in compliance with Rule 4 of the Federal Rules of Civil Procedure ("FRCP"), BAI would certainly feel free, and rightly so, to ignore the complaint. There is no question that such "service" could not survive a motion under FRCP Rule 12(b) to dismiss for insufficiency of service of process. *See, e.g., Dodco, Inc. v. American Bonding Co.*, 7 F.3d 1387 (8th Cir. 1993); *Norris v. State of Georgia*, 522 F.2d 1006 (4th Cir. 1975); *United States v. Laughlin*, 1997 Bankr. LEXIS 1204 (1st Cir. BAP 1997).[1]

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[1] "If a defendant is improperly served, the court lacks jurisdiction over the defendant" and the case should be dismissed. *Dodco*, 7 F.3d at 1388. "We exercise only that jurisdiction as was acquired by personal service and grant only that relief which we are capable of delivering * * *." *Norris*, 522 F.2d at 1014 (dismissing claims against persons who were not properly served). "***Because the trustee failed to properly serve the United States with his motion, personal jurisdiction was lacking***. Fed. R. Bankr. P. 7004(f). Notice to the IRS through its local Special Procedures Staff does

Further, the following two simple hypothetical examples illustrate that the question, "Does the court have jurisdiction over this person?" requires a more careful qualification of the answer than was given by the Fourth Circuit in the opinion from which this petition arises:

Example 1: A personal injury action is commenced by Jones, a South Carolina resident, in the United States District Court for the Western District of North Carolina against Smith, a resident of that district, who is served with summons and complaint. Does the District Court have jurisdiction over Smith? Clearly, the answer is yes.

Jones also files a separate breach of contract action against Smith arising from completely separate facts, but summons and complaint are not served on Smith. Smith receives but ignores a motion for default, and a default judgment is entered against Smith. Does the District Court have jurisdiction over Smith? The answer is no, not for entering judgment against Smith in the contract action. Thus, the District Court has personal jurisdiction over Smith for some purposes, but not for others.

Smith may not hear of the default judgment for some time and may then be living far outside the jurisdiction. However, under the Fourth Circuit's opinion below, Smith could not collaterally attack the judgment wherever Jones attempts to execute on the judgment against him, and Smith's sole remedy would be to return to the Western District and move for a reconsideration of the entry of judgment.

Example 2: An elderly farmer in Virginia is asked by his neighbor to lend him $50,000. The loan is made, and it is secured by a first mortgage on the neighbor's farm. The neighbor's health worsens, he moves near his daughter in

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not cure the jurisdictional defect." *Laughlin*, 1997 Bankr. LEXIS 1204 (emphasis added).

Seattle, and he later files bankruptcy because of his health-care costs. The farmer in Virginia receives from the bankruptcy court in the Western District of Washington a 15-day notice of the sale of his former neighbor's farm with the proceeds to be paid to a hospital's junior lien, but he does not realize the import of the notice and ignores it.

Under the Fourth Circuit's opinion below, the lien of the farmer's mortgage is gone. The farmer was served with no summons and complaint such as would put him on proper and sufficient notice of the impending loss of his lien on real property and would cause him to consult legal counsel. The farmer received some process, but not due process. However, the Fourth Circuit, laboring under its misinterpretation of *Celotex*, would find such due process not to be necessary.

**D. Other courts agree.** In *Matter of Howard*, 972 F.2d at 641, the Fifth Circuit held that "[t]he general applicability of *res judicata* to bankruptcy plan confirmations must give way, however, to the interest of the secured creditor" when the creditor is not given statutorily required notice. The creditor held mortgages on real property, and the plan provided that the creditor would be paid $500 and its liens lifted. The creditor collaterally attacked the order of confirmation through a motion for relief from stay to foreclose its mortgages (rather than directly attacking by appealing the confirmation order or by seeking FRCP Rule 60(b) relief from the order). The court refused to give the confirmation order *res judicata* effect and allowed the collateral attack.

*Matter of Beard*, 112 B.R. 951 (Bankr. N.D. Ind. 1990) is often cited with approval on the limitation of the jurisdiction of a bankruptcy court to determine the validity or priority of a lien without commencing an adversary proceeding. In *Beard*, the issue was whether the IRS's tax lien was destroyed by confirmation of the debtor's Chapter 13 plan. The court held:

> "Since it is at best a contested matter, the only questions which are properly before the court in the context of confirmation are those which can be raised as contested matters. Only as to issues of this kind will confirmation operate as *res judicata*. * * *
>
> "A challenge which questions the validity or existence of a lien, its extent or the scope of the property encompassed by it, or the lien's priority in relation to other interests, however, requires an adversary proceeding. Disputes of this nature are not resolved by the confirmation process. * * * [A] secured creditor is not bound by the terms of the confirmed plan with respect to limitations upon the scope or validity of the lien securing its claim." 112 B.R. at 955-956.

In a case with facts remarkably similar to those of the present case, a farmers' co-op brought suit in state court against a bank on the basis that the co-op had a valid and perfected first-priority lien on a farmer's crops and that the bank had converted the proceeds of that crop. The bank denied the priority of the co-op's lien and the allegations of conversion on the basis that the farmer had filed bankruptcy, that the bankruptcy plan had been confirmed, that the plan provided for distribution of the crop proceeds to the bank, and that all creditors of the farmer, including the co-op, were bound by the plan. *Antelope Cty. Farmers v. Citizens St. Bank*, 240 Neb. 760, 484 N.W.2d at 823.

The plan provided that the farmer's crops and proceeds would be surrendered to the bank. The check was jointly payable to the co-op, the bank, and the farmer, but the co-op refused to endorse the check for the bank. The parties later filed a stipulation that the co-op would endorse the check without waiving any rights or causes of action with regard to

said moneys. The co-op then brought the conversion action in state court. 484 N.W.2d at 825. After analyzing and approving of the decision in *Beard* cited above, the Nebraska Supreme Court held:

> "[B]ankruptcy law does not permit an allowed secured claim protected by the Bankruptcy Code and this state's statutes to be avoided merely by confirmation of a plan in bankruptcy without an adversary proceeding to protect the rights of creditors. * * *
>
> "We find that it was improper for the trial court to find that the issue before it, namely priority of the competing liens, was res judicata. The bankruptcy court had not determined this issue, nor did it have jurisdiction to do so. A fact question exists as to the relative priority of the lien of the Bank and Co-op. The court erred in granting the Bank's motion for summary judgment. We therefore reverse * * *." 484 N.W.2d at 830.

The opinion in *Antelope County* is entirely consistent with *Cen-Pen* and supports Spartan's position in this case: 1) an order of the bankruptcy court entered pursuant to a contested matter that is determined by notice and a hearing is not *res judicata* with regard to the priority of competing liens, which can be determined only in an adversary proceeding commenced with summons and complaint; and 2) the order of the bankruptcy court in the contested matter may be collaterally attacked in another forum.

**E. Summary.** It appears that the Fourth Circuit's opinion below arises from the misapprehension that if a bankruptcy court ***could*** have jurisdiction to enter an order, then it has such jurisdiction, without regard for the procedure used by the court. This opinion fails to take into account the rule of

law that a bankruptcy court may have jurisdiction ... for some purposes but not others. As shown by ... authorities, a bankruptcy court's failure to require sum... and complaint to determine the validity or priority of a ... precludes *res judicata* effect being accorded to the order.

## II.

**A bankruptcy court does not have jurisdiction to enter an order determining the priority of liens in proceeds of the sale of property of the estate, when such liens exceed the amount of the proceeds and the lien-priority determination would have no effect on the estate or on creditors other than the creditors holding liens.**

In *Celotex*, this Court notes the limitation on the jurisdiction of bankruptcy courts:

> "The usual articulation of the test for determining whether a civil proceeding is related to bankruptcy is whether *the outcome of that proceeding could conceivably have any effect on the estate being administered in bankruptcy* * * *.
>
> "The First, Fourth, Fifth, Sixth, Eighth, Ninth, Tenth and Eleventh Circuits have adopted [this] test with little or no variation. * * * [T]hese cases make clear that bankruptcy courts have no jurisdiction over proceedings that have no effect on the debtor." 115 S.Ct. at 1499 n.6 (emphasis in original).

The proceeds of the auction sale were $810,000, and, after paying certain claims of the examiner and other parties, a balance of $781,075 remained. The Sale Order states that BAI's security interest secured a claim of $804,844, exclusive of costs and legal fees. Spartan's lien secured a claim of

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$633,090, plus accrued interest. Therefore, depending upon the relative priority of BAI's security interest and Spartan's lien, the remaining proceeds would be distributed (a) about $633,000 to Spartan and about $148,000 to BAI or (b) entirely to BAI. In either case, the sum of the unsatisfied (and thus unsecured) claims of Spartan and BAI is about $657,000.

Under either outcome, there is no effect on the debtor or the bankruptcy estate. There could be no distribution of the proceeds of the sale authorized by the Sale Order on the unsecured claim of any creditor other than Spartan or BAI, and thus the allocation of the proceeds between Spartan and BAI could have no effect on the estate. Therefore, following *Celotex*, the Bankruptcy Court had no jurisdiction to determine the distribution of the proceeds between Spartan and BAI. The court could have, and should have, left the proceeds in escrow with the attorney for Dash and commended Spartan and BAI to another forum to work out their differences, the resolution of which would have had no effect upon the estate.[2] At that point in the case, the Bankruptcy Court was without jurisdiction to determine Spartan's lien rights in the Sale Order, and it follows that *res judicata* effect should not be given to that order.

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[2] This conclusion is buttressed by a further consideration. The Bankruptcy Court's docket sheet for Dash's case shows an order entered on September 20, 1993, that converted the case from a Chapter 11 case to a Chapter 7 case effective October 1, 1993. This order, which was entered four days before the Sale Order, shows that Dash's case was a liquidation rather than a reorganization. The case was not earlier converted solely to avoid the added administrative costs (*i.e.*, trustee fees) that would be incurred by conversion before approval of the sale. As noted in *Celotex*, the jurisdiction of bankruptcy courts may be more restricted in a Chapter 7 liquidation than in a Chapter 11 reorganization. 115 S.Ct. at 1500. At the time of the entry of the Sale Order, Dash's bankruptcy case was in effect a Chapter 7 liquidation, and it formally became so less than one week later.

## III.

**If an order is entered by a bankruptcy court without jurisdiction properly being established, the order is subject to collateral attack in another court.**

The constitutional right to due process would be merely an intellectual curiosity if the judicial response to a trampling of such right did not encompass a remedy. As set forth below, a bankruptcy court's order entered in violation of a creditor's due process rights is not to be given *res judicata* effect. Thus, in the present case, the Fourth Circuit erred in giving such effect to the Sale Order and to the DIP Financing Order.

**A. An order entered without jurisdiction is void and without *res judicata* effect.** In the opinion from which this petition arises, the Fourth Circuit states what it believes to have been Spartan's only remedy:

> "[W]e believe that if Spartan Mills knew that proper bankruptcy procedure had not been followed, its remedy was to seek reconsideration from the bankruptcy court itself or to appeal to the district court in Florida and ultimately to the Eleventh Circuit." 112 F.3d at 1256 (App. A, 10a).

It is implicit in the *City of New York* opinion by this Court that a bankruptcy order that fails to provide due process to the holder of a lien is not entitled to *res judicata* effect. The district court's opinion in that case shows that the order confirming the bankrupt's plan and discharging its property of those liens not provided for in the plan was entered on September 6, 1945. *In re New York, N.H. & H.R. Co.*, 105 F.Supp. 413, 417 (D. Conn. 1951), *aff'd*, 197 F.2d 428, *rev'd*, 344 U.S. 293, 73 S.Ct. 299 (1953). However, the controversy arose when the reorganized railroad much later petitioned the district court for instructions as to whether the confirmed plan

invalidated the City of New York's liens, and the district court entered its order so finding nearly six years after entry of the confirmation order.

The Fourth Circuit opinion below provides that the only remedy for an order entered with constitutionally deficient notice is an appeal or petition for relief under FRCP Rule 60(b).[3] 112 F.3d at 1256 (App. A, 10a). If this conclusion were correct, then this Court in the *City of New York* decision would have affirmed the denial of the City's liens based on the lack of a timely appeal or petition for relief from the confirmation order. That this Court did not do this implicitly shows that there is to be no *res judicata* effect from orders entered with constitutionally deficient notice and that such orders may be collaterally attacked in any forum.[4]

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[3] Such motions are within the discretion of the court, *Northshore Devel., Inc. v. Lee*, 835 F.2d 580, 582 (5th Cir. 1992), and appellate review would be limited to determining whether the Bankruptcy Court abused its discretion in denying relief. *Northshore*, 835 F.2d at 582; *Simmons v. Gorsuch*, 715 F.2d 1248, 1253 (7th Cir. 1983). "The standard of review for a denial of a Rule 60(b) motion places a heavy burden on the appellant * * *." *Northshore*, 835 F.2d at 582. "Abuse of discretion in this context 'is established only where no reasonable man could agree with the district court; if reasonable men could disagree as to the propriety of the court's action, no abuse of discretion has been shown.'" *Simmons*, 715 F.2d at 1253.

In *Mullane*, this Court said: "But when notice is a person's due, process which is a mere gesture is not due process." 339 U.S. at 314, 70 S.Ct. at 657. Spartan is entitled to such due process as would allow it to have its lien rights determined on a fair, equal, preponderance-of-the-evidence basis. As the Fourth Circuit erroneously interpreted *Celotex*, the fortuitous (to BAI) procedural missteps of BAI and Dash regarding the DIP Financing Order and the Sale Order would result in the Bankruptcy Court's being asked by Spartan, after the time for appeal had expired, to reconsider its order, and, if it denied that request, Spartan would be arguing for reversal on the very difficult abuse-of-discretion standard. This "mere gesture" that the Fourth Circuit offered does not comprise due process.

[4] It is only happenstance that the bankrupt railroad first sought a declaration from the district court in Connecticut that had heard the bankruptcy case; clearly this Court's ruling would not have been different if

Well-established jurisprudence of South Carolina, where the District Court was located, and the Fourth Circuit provides that the effect of a failure to obtain jurisdiction over the defendant is that the judgment is a nullity and is subject to collateral attack in any court:

> "A judgment, void for lack of jurisdiction over a defendant, may be collaterally attacked in a second proceeding * * *." *Crowe v. Crowe*, 289 S.C. 330, 345 S.E.2d 498, 499 (1986).
>
> "A void judgment is one that has been * * * entered by a court that did not have jurisdiction over the subject matter or the parties." *Quarles v. Miller*, 86 F.3d 55, 56 (4th Cir. 1996).

**B. Prior to *Celotex*, the Fourth Circuit had held that a bankruptcy court order entered without jurisdiction is subject to collateral attack.** In *Linkous*, the Chapter 13 debtors sought to determine the valuation of the collateral for a secured creditor's claim through the confirmation of their plan. The Fourth Circuit found that FRBP Rule 3012 allowed such a determination "'after a hearing ***on notice to the holder of the secured claim*** * * *.'" 990 F.2d at 162 (emphasis in *Linkous* opinion), and the Fourth Circuit observed that, although the secured creditor had received general notice of the hearing on confirmation of the plan:

> "'[m]ere notice that the bankruptcy court will hold a confirmation hearing on a proposed bankruptcy plan, ***without inclusion of notice***

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the City of New York had sought to foreclose its liens in either the district court or the state court in New York. In the passage from *Mullane* quoted above at page 13, this Court strongly indicated that if the notice for a proceeding is constitutionally deficient, then that proceeding is not to be accorded finality.

> ***specifically directed at the security valuation process***, does not satisfy the requirement of Rule 3012.' [*In re Calvert*,] 907 F. 2d [1069] at 1072 [(11th Cir. 1990)].
>
> "In order to satisfy due process requirements, 'the notice [of the proceedings] must be of such nature as reasonably to convey the required information....' *Mullane*, 339 U.S. at 314, 70 S.Ct. at 657. * * * Consequently, the notice to [the secured creditor] was inadequate as it did not make reference to an intent to reevaluate the secured claims * * *." 990 F.2d at 162-163 (emphasis added).

Having determined that the notice was constitutionally deficient, the court stated the effect of such a determination:

> "[A] bankruptcy court confirmation order ***generally*** is treated as *res judicata*. ***However, we cannot defer to such an order on res judicata grounds if it would result in a denial of due process in violation of the Fifth Amendment of the United States Constitution.*** * * * Accordingly, we cannot accord the bankruptcy court's order the finality which would attach if the notice given to [the secured creditor] was adequate." 990 F.2d at 162 (emphasis added).

The Fourth Circuit made the same point in *Cen-Pen*, where it stated that:

> "The [Debtors'] reliance on [11 U.S.C.] § 1327 fails to appreciate the import of these Rules [FRBP Rules 7001, 7003, and 7004]. Because confirmation of a Chapter 13 plan is

> *res judicata **only*** as to issues that can be raised in the less formal procedure for contested matters, ***confirmation generally cannot have preclusive effect as to the validity of a lien, which must be resolved in an adversary proceeding.***" 58 F.3d at 93 (emphasis added, citations omitted).
>
> "[A] creditor with a loan secured by a lien on the debtor's property is free to ignore the bankruptcy proceeding and look solely to the lien for satisfaction of the debt." 58 F.3d at 94.

Clearly, these passages do not mean that such a creditor could ignore the constitutionally and statutorily required notice in the form of service of summons and complaint, but it does mean that such a creditor could ignore the various notices that arrive in the mail from a bankruptcy court including, as in *Cen-Pen*, a notice of a confirmation hearing. For the creditor to be able to ignore such a notice, any order following upon the notice must, *a priori*, not be given *res judicata* effect. In the present case, the Fourth Circuit incorrectly interpreted *Celotex* to conclude that the DIP Financing Order and the Sale Order were entitled to *res judicata* effect even if the proper procedure of service of summons and complaint was not followed.

**C. Other courts agree.** Other courts have found collateral attack to be appropriate when a bankruptcy court fails to obtain jurisdiction by following proper procedure:

**The Seventh Circuit.** In *Union Carbide Corp. v. Newboles*, 686 F.2d 593 (7th Cir. 1982), an appeal from a diversity action to collect on personal guaranties, the Seventh Circuit found that a bankruptcy court did not have the authority to enter a confirmation order for a plan of reorganization of a corporate debtor that provided for the discharge of personal liability of non-debtor guarantors of debts of the corporation.

The creditor holding the guaranties was not sent back to the bankruptcy court for a modification of the confirmation order. The court found the bankruptcy court exceeded its jurisdiction and thus the order had no effect on the claims against the guarantors. The Seventh Circuit held that if a bankruptcy court order is not authorized by the then-applicable Bankruptcy Act, then the order is of no effect and subject to collateral attack in any forum. The bankruptcy court's lack of jurisdiction to enter the order deprives it of *res judicata* effect.

**The Eleventh Circuit.** In *In re Spring Valley Farms*, 863 F.2d 832 (11th Cir. 1989), the Eleventh Circuit held that the order confirming a plan of reorganization, which expressly discharged the corporate debtor of its debts (*see*, *In re Spring Valley Farms*, 68 B.R. 756, 757 (Bankr. N.D. Ala. 1986)), did not effect the discharge of the debt to a creditor who was known to the debtor but did not receive written notice of the claims bar date as required by FRBP Rule 2002, even though the creditor knew of the general existence of the bankruptcy case. 863 F.2d at 835. The bankruptcy case was in the Western District of North Carolina, but the Eleventh Circuit's opinion arose from a lawsuit commenced in the Circuit Court of Etowah County, Alabama, before the bankruptcy case filing and removed to the bankruptcy court in Alabama more than a year after confirmation. 68 B.R. at 756-757.

The Eleventh Circuit did not accord *res judicata* effect to the North Carolina confirmation order regarding this creditor and did not require the creditor to seek its relief from the confirmation order solely from the North Carolina bankruptcy court that issued it. Collateral attack of a bankruptcy court order in a different court was permitted because the plaintiff, although having actual knowledge of the bankruptcy case, had not received ***proper*** notice of the confirmation order.

**The Fifth Circuit.** In *Matter of Howard*, 972 F.2d at 641, the Fifth Circuit held that "[t]he general applicability of *res judicata* to bankruptcy plan confirmations must give way,

however, to the interest of the secured creditor" when the creditor is not given statutorily required notice. The creditor held real-property mortgages, and the plan stated the creditor would be paid $500 and its liens lifted. The creditor collaterally attacked the confirmation order by filing a motion for relief from stay to foreclose its mortgages (rather than directly attacking by appealing the confirmation order or seeking FRCP Rule 60(b) relief from the order). The court did not give *res judicata* effect to the confirmation order and allowed the collateral attack.

**The Federal Circuit.** In *Broomall Industries v. Data Design Logic Systems*, 786 F.2d 401 (Fed. Cir. 1986), the court, relying on *Mullane v. Central Hanover Bank & Trust* and *City of New York v. New York, N.H. & H.R. Co.*, held that Fifth Amendment due process considerations take precedence over the discharge provisions of section 1141 of the Bankruptcy Code where the debtor failed to give a known creditor actual notice of the confirmation hearing. Consistent with *Cen-Pen*, the Federal Circuit did not give *res judicata* effect to the bankruptcy court's confirmation order with regard to the creditor's claim. The confirmation order was entered on July 29, 1981, and the action appealed to the Federal Circuit was commenced by the creditor nearly two years later in the district court on July 7, 1983, but the creditor was not relegated to a hopeless FRCP Rule 60(b) motion before the bankruptcy court.

**The Tenth Circuit.** In *Reliable Elec. Co., Inc. v. Olson Const. Co.*, 726 F.2d 620, 623 & n.6 (10th Cir. 1984), the court held that an unsecured creditor's "guarantied right to due process is paramount" to the debtor's "fresh start" rights, so the debtor's failure to give the creditor adequate notice of a confirmation hearing meant the creditor's claim was not subject to the plan and not discharged by the confirmation order. The court cited *New York* for the rule that "[t]he creditor has a 'right to assume' that he will receive all of the notices ***required by statute*** before his claim is forever barred." 726 F.2d at 622 (emphasis added). This collateral attack on the confirmation

order was initiated by the debtor's motion to allow the creditor's claim and to subject the claim to the plan treatment.

**Alabama Supreme Court.** As in *Union Carbide*, the Alabama Supreme Court in *Zickler v. Shultz*, 603 So.2d 916, 920 (Ala. 1992), found that a bankruptcy court lacked the authority to confirm a plan of a corporate debtor that purported to discharge the personal liability of non-debtor guarantors. The court did not send the creditor holding the guaranties back to the bankruptcy court. The court found that the bankruptcy court went beyond its jurisdiction and held that, as to the claims against the guarantors, the order was not *res judicata*. A collateral attack on an order that exceeded the bankruptcy court's jurisdiction was permitted in a different forum.

**Nebraska Supreme Court.** In *Antelope*, 240 Neb. 760, 484 N.W.2d at 823, the Nebraska Supreme Court refused to give *res judicata* effect to an order of a bankruptcy court that exceeded its jurisdiction by discharging a non-debtor.

**First Circuit Bankruptcy Appellate Panel.** In *Laughlin*, 1997 Bankr. LEXIS 1204, after finding that the trustee failed to properly serve the United States as required by FRBP Rule 7004, the First Circuit Bankruptcy Appellate Panel held that the resulting order was void and was a nullity.

As shown by the above decisions and the arguments upon which they are based, the orders of the Bankruptcy Court purporting to determine the validity or priority of Spartan's lien (which orders include both the DIP Financing Order and the Sale Order) are void for lack of the Bankruptcy Court's properly establishing jurisdiction over Spartan and its lien, and thus these orders were subject to collateral attack by Spartan.

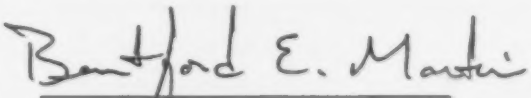
## CONCLUSION

There is a split between the Circuit Courts of Appeal (and including the highest courts of Nebraska and Alabama) on

whether a bankruptcy court must give statutorily required notice when determining a creditor's lien rights and on whether, if such statutorily required notice was not given through the employment of less formal procedures, the resultant order is to be given *res judicata* effect. The Fourth Circuit, through an overly broad reading of *Celotex*, wrongly concluded that statutorily required notice need not be given and that a resultant order is *res judicata* on these matters.

This rule newly adopted by the Fourth Circuit would reward and encourage attempts to destroy secured creditors' liens by the subterfuge of proceeding with informal notice rather than the statutorily commanded summons and complaint. The Fourth Circuit stated, "Respect for the orderly process of law demands that the Florida Bankruptcy court's final, unappealed order be given effect." 112 F.3d at 1258 (App. A, 12a). However, respect for the orderly process of law demands that the Congressionally and Constitutionally mandated procedure of summons and complaint be followed. At a stroke, the Fourth Circuit has swept aside FRBP Rules 7001, 7003, and 7004 and the rules of law that this Court stated in *Mullane v. Central Hanover Bank & Trust*, and *City of New York v. New York, N.H. & H.R. Co.* For the reasons set forth above, this petition for writ of certiorari should be granted.

Respectfully submitted,



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No.

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In The

# Supreme Court of the United States

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October Term, 1997

**SPARTAN MILLS,**

*Petitioner,*

*vs.*

**BANK OF AMERICA ILLINOIS,**

*Respondent.*

*On Petition for Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit*

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## APPENDIX

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# APPENDIX A - OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT DATED MAY 6, 1997

**SPARTAN MILLS, Plaintiff-Appellant,**

**v.**

**BANK OF AMERICA ILLINOIS, Defendant-Appellee.**

**No. 96-1760.**

United States Court of Appeals, Fourth Circuit

Argued January 30, 1997 Decided May 6, 1997

OPINION

NIEMEYER, Circuit Judge:

Spartan Mills filed this action against Bank of America Illinois in the District of South Carolina to enforce a state statutory textile processor's lien against the sale proceeds of certain equipment and inventory of Dash Industries, Inc., a debtor in bankruptcy. Spartan Mills claims to have a first priority position in those proceeds. The equipment and inventory had been sold by order of a Florida bankruptcy court and the proceeds paid to Bank of America, Dash Industries' bank, pursuant to the bankruptcy court's finding that the bank had a first priority security interest in the assets. Bank of America contends that the bankruptcy court's final order determining that its lien had priority in Dash Industries' assets now precludes Spartan Mills, under principles of res judicata, from relitigating that issue in this action. The district court agreed and entered summary judgment in Bank of America's favor. We affirm.

I

Dash Industries, a Florida apparel manufacturer and distributor, retained Spartan Mills to make sheet metal "screens" for transferring Dash Industries designs onto fabric and to manufacture the fabric itself. In the spring and summer of 1993, Dash Industries owed Spartan Mills over $600,000 for these services. To secure payment of Dash Industries' outstanding debt with Spartan Mills, Spartan Mills asserted a first priority, possessory textile processor's lien pursuant to S.C. Code § 29-15-70 in the screens, related equipment, and fabric in its custody.

In May 1993, Dash Industries filed a Chapter 11 bankruptcy proceeding in the Bankruptcy Court for the Southern District of Florida. As part of its reorganization plan, Dash Industries sought to finance its ongoing operations through a continuing arrangement with Bank of America Illinois, its bank, to whom Dash Industries was already indebted in an amount exceeding $1.5 million. Bank of America claimed a first priority lien in all of Dash Industries' assets to secure repayment of outstanding loans. By order dated June 11, 1993, the bankruptcy judge authorized Dash Industries to continue to borrow from Bank of America and limited Dash Industries' use of Bank of America's cash collateral. To provide Bank of America sufficient security to continue financing Dash Industries, the bankruptcy judge recognized the bank's "lien against and security interest in all presently owned and hereafter acquired property, assets, and rights, of any kind or nature, of the Debtor, wherever located." The court also ordered provisionally that the lien and security interest "shall be a first and prior lien on and security interest in" the assets of Dash Industries. The bankruptcy court expressly stated in its order, however, that it was not *then* determining the "validity, priority, or extent of" Bank of America's pre-petition rights or lien upon Dash Industries' assets. Rather, it was notifying all creditors that, if any creditor wished to challenge "the validity or priority of [Bank

of America's] claims or liens," it was required to file a motion or other pleading doing so by August 15, 1993. The court warned that if no motion or pleading were so filed, the first priority lien position of Bank of America would be established "as a finding of this Court and . . . shall no longer be provisional." The bankruptcy court's June 11 order included the following admonition:

> Consistent with the foregoing, any objection to the claims or liens of [Bank of America] and any adversary proceeding or other action alleging an affirmative claim on behalf of [Dash Industries'] bankruptcy estate for relief in damages or otherwise against [Bank of America] must be brought on or before August 15, 1993 *or be otherwise barred.*

(Emphasis added). Spartan Mills received a copy of this June 11 order, and, during this same period, its counsel, on his own application, became the representative of the unsecured creditors committee. Despite the bankruptcy court's order that Bank of America would be given a first priority lien on Dash Industries' assets unless an objection or adversary proceeding were commenced by August 15, 1993, Spartan Mills neither made any objection nor filed any motion, pleading, or adversary proceeding by that date.

After the closing date for filing objections or adversary proceedings, the bankruptcy judge entered an order dated August 24, 1993, directing the court-appointed examiner to sell all of Dash Industries' assets "free and clear of liens in parcel or bulk with liens attaching to the proceeds." And following the sale of the assets to Cone Mills for $810,000 -- netting $781,075 to the bankruptcy estate after payment of expenses -- the bankruptcy court entered an order of September 2 approving the sale "free and clear of liens, with liens to attach to proceeds," subject to objection if filed by September 15, 1993. Spartan Mills received a copy of these

orders also. Although it did not object to the sale, on September 15, 1993, Spartan Mills did file an adversary proceeding in the bankruptcy court to declare that its textile processor's lien was valid and prior to any other lien. The docket sheet discloses, however, that Spartan Mills took no further steps to prosecute its adversary proceeding.

On September 20, 1993, the bankruptcy court converted Dash Industries' bankruptcy from Chapter 11 to Chapter 7. Also on that date, Dash Industries sent Spartan Mills a draft order approving the sale, which provided that the sale proceeds were to be held in escrow "pending further order of this Court." Three days later, however, Bank of America filed a limited objection to the draft order that requested immediate disbursement to Bank of America of its share of the sale proceeds "[p]ursuant to this Court's June 11, 1993, Order." Bank of America served a copy of the objection on Spartan Mills.

Finally, on September 24, 1993, the bankruptcy court approved the sale of assets to Cone Mills "free and clear of liens." Its order found that Bank of America "holds a valid and duly perfected security interest in all of [Dash Industries'] assets" and that "[n]o other creditors hold valid and duly perfected security interests in the assets." The court further directed that the proceeds of the sale be paid to Bank of America in satisfaction of its lien at the closing date, October 15, 1993. Spartan Mills acknowledges that it was served directly with a copy of this order, receiving it on September 27, 1993. Its attorneys contend, however, that *they* did not receive a copy of the court's September 24 order until several weeks later, noting that, as of September 19, they no longer represented the creditors' committee.

Nevertheless, before payment of the sale proceeds was made to Bank of America, Spartan Mills negotiated and entered into an agreement with Bank of America on October 14, 1993, under which it agreed to relinquish possession of the

equipment and inventory to Cone Mills so as to allow completion of the court-ordered sale. It imposed as its condition, however, that Bank of America agree that in any litigation over the entitlement to the sale proceeds, "Spartan Mills will not be deemed to have relinquished the Property for the purposes of determining the attachments, perfection and priority of its asserted lien therein." Thereafter, the bankruptcy estate paid $781,075 to Bank of America, and two months later Spartan Mills dismissed its adversary proceeding to determine its priority.

A year-and-a-half later, on May 18, 1995, Spartan Mills filed this action in the District of South Carolina seeking (1) a declaratory judgment that its lien was superior to Bank of America's lien and that, therefore, Bank of America converted its property and (2) a judgment in the amount that Dash Industries owed to Spartan Mills, plus interest. Bank of America filed a counterclaim for a declaratory judgment that the Florida bankruptcy court had previously decided the priority of liens and that Spartan Mills was now bound by the bankruptcy court's order. On cross-motions for summary judgment, the district court granted Bank of America's motion for summary judgment. The district court noted that, even if the Florida bankruptcy court erred in ordering payment of the proceeds to Bank of America without the institution of an adversary proceeding or resolution of Spartan Mills' adversary proceeding, the Florida court's order adjudicating the liens' priorities was a final order which Spartan Mills neither appealed nor challenged. Relying on *Celotex Corp. v. Edwards*, 514 U.S. 300, 115 S. Ct. 1493, 131 L.Ed.2d 403 (1995) (upholding a final bankruptcy court order against collateral attack), the district court concluded:

> If Spartan feels the Bankruptcy Court exceeded its jurisdiction or did not accord Spartan due process, then Spartan's remedy lies in Florida not in South Carolina. Spartan's action constitutes an improper collateral attack on the

Sale Order issued by the United States Bankruptcy Court for the Southern District of Florida, and thus, the Sale Order may not be challenged in this forum.

II

The judicial system's need for order and finality requires that orders of courts having jurisdiction to enter them be obeyed until reversed, even if proper grounds exist to challenge them. A challenge for error may be directed to the ordering court or a higher court, as rules provide, but it may not be made collaterally unless it is based on the original court's lack of jurisdiction. These principles are firm and long standing. *See Celotex Corp. v. Edwards*, 514 U.S. 300, ____, 115 S. Ct. 1493, 1498, 131 L.Ed.2d 403 (1995).

In *Celotex*, the Supreme Court barred judgment creditors from executing against the supersedeas bond of the judgment debtor's surety when such execution would have collaterally attacked the injunction of a bankruptcy court with jurisdiction, even though the creditors had proper grounds to object to the injunction. The court stated, "'persons subject to an injunctive order issued by a court with jurisdiction are expected to obey the decree until it is modified or reversed, even if they have proper grounds to object to the order.'" *Id.* at ____, 115 S. Ct. at 1498 (quoting *GTE Sylvania, Inc. v. Consumers Union*, 445 U.S. 375, 386, 100 S. Ct. 1194, 1201, 63 L.Ed.2d 467 (1980)). The Court observed that this rule had been applied to bankruptcy orders for more than 60 years. *See Celotex*, 514 U.S. at ____, 115 S. Ct. at 1498; *Oriel v. Russell*, 278 U.S. 358, 49 S. Ct. 173, 73 L.Ed. 419 (1929) (holding that a bankruptcy turnover order could not be collaterally attacked in a later contempt proceeding brought to enforce it).

In this case, the Florida bankruptcy court issued an order on June 11, 1993, provisionally finding that Bank of

America had a first priority lien on all of Dash Industries' assets, including its equipment and inventory. And in its orders of August 24 and September 2, the court ordered the sale of those assets free and clear of all liens, with liens to attach to the sale proceeds. Finally, on September 24, 1993, following a period which the court allowed for creditors to object, the bankruptcy court ratified the sale and ordered that the net proceeds be paid to Bank of America as lien holder enjoying a first priority position.

Spartan Mills had notice of these orders but failed to object to or appeal them. While it did file an adversary proceeding, it voluntarily dismissed it. If the bankruptcy court had jurisdiction to enter these orders, under *Celotex* we must consider them binding on Spartan Mills, even if they were in error, and therefore must reject this collateral attack. *See Lindsey v. Ipock*, 732 F.2d 619, 622 (8th Cir. 1984) ("once [the creditor] was apprised of the bankruptcy court's sale order and failed to timely appeal, he was obligated to obey these orders even if they were in error").

Spartan Mills contends that it is not governed by the principles of *Celotex* because (1) the Florida bankruptcy court did not have jurisdiction over the subject matter or over the person of Spartan Mills and (2) the bankruptcy court did not follow established procedures for voiding its lien, denying Spartan Mills the due process notice that would give preclusive effect to the bankruptcy court's orders. We will discuss these issues in order.

A

No one contends that the bankruptcy court did not have jurisdiction over Dash Industries and its assets, both to reorganize them under Chapter 11 and later to liquidate them under Chapter 7. *See* 28 U.S.C. §§ 157(a), 1334(b). "Congress intended to grant comprehensive jurisdiction to the bankruptcy courts so that they might deal efficiently and

expeditiously with all matters connected with the bankruptcy estate, and . . . the 'related to' language of § 1334(b) must be read to give district courts (and bankruptcy courts under § 157(a)) jurisdiction over more than simple proceedings involving the property of the debtor or the estate." *Celotex*, 514 U.S. at ____, 115 S. Ct. at 1499 (internal quotations omitted). Accordingly, a district court, and derivatively the bankruptcy court, has jurisdiction over an action related to bankruptcy "if the outcome could alter the debtor's rights, liabilities, options, or freedom of action (either positively or negatively) and[it] in any way impacts upon the handling and administration of the bankrupt estate." *Pacor, Inc. v. Higgins*, 743 F.2d 984, 994 (3d Cir. 1984); *see also A.H. Robins Co. v. Piccinin*, 788 F.2d 994, 1002 n.11 (4th Cir. 1986) (adopting the *Pacor* test).

Spartan Mills contends nevertheless that the bankruptcy court had no jurisdiction to settle the private dispute between it and Bank of America over the relative priority of their liens because the distribution of the proceeds to one or the other would have no effect on the debtor's estate. Such an argument, however, ignores the fact that recognition of Bank of America's first priority position was essential to the initial reorganization and later liquidation of Dash Industries' estate. All of the corporation's Chapter 11 financing was dependent on Bank of America's first lien position, and the later sale of the estate's assets could not have been completed if a valid claim of a possessory lien had been interposed. The "determination[ ] of the validity, extent, or priority of liens" is at the heart of this bankruptcy case and statutorily within the core of the bankruptcy court's "related to" jurisdiction. *See* 28 U.S.C. § 157(b)(2)(K). We have little difficulty in concluding that the Florida bankruptcy court had subject matter jurisdiction over all of Dash Industries' assets and any lien contest in respect to them.

It also cannot be disputed that Spartan Mills was a party to the bankruptcy proceedings in Florida. It was a

creditor; it received notice of all proceedings; it served as representative of the creditors' committee; and it filed its own adversary proceeding in the case.

B

For its weightier argument, Spartan Mills contends that the bankruptcy court's departure from established procedure for adjudicating the priority of liens denied it the due process notice necessary to bind it through principles of res judicata. It argues that our decision in *Cen-Pen Corp. v. Hanson*, 58 F.3d 89 (4th Cir. 1995), squarely supports its position. In *Cen-Pen*, we held that a confirmation order that treated Cen-Pen as an unsecured creditor of the debtor in bankruptcy could not have preclusive effect as to the validity of a lien that Cen-Pen claimed in the debtor's assets. We stated, "confirmation generally cannot have preclusive effect as to the validity of a lien, which must be resolved in an adversary proceeding." *Id.* at 93. We noted that inclusion of boilerplate language on page four of the debtors' proposed plan voiding liens did not, in the circumstances there, provide sufficient notice to the creditor that his lien was not being allowed to pass through the bankruptcy process intact: "The Hansons' plan nowhere mentioned or otherwise acknowledged Cen-Pen's liens, and certainly did not 'provide for' treatment of the liens or full payment of the underlying claim." *Id.* at 94. Even though Spartan Mills cannot rely on a similar factual circumstance here, it nonetheless argues that because it was not served with notice in an adversary proceeding filed to invalidate its first priority, textile processor's lien created under South Carolina law, under *Cen-Pen* it is not bound by the bankruptcy court's final order distributing the proceeds to Bank of America. We think that Spartan Mills applies *Cen-Pen* too broadly.

While it is clear that no one instituted an adversary proceeding against Spartan Mills for the purpose of subordinating its textile processor's lien, Spartan Mills itself

did institute such an action, even though it did not prosecute it. But apart from its own action in filing an adversary proceeding, we believe that if Spartan Mills knew that proper bankruptcy procedure had not been followed, its remedy was to seek reconsideration from the bankruptcy court itself or to appeal to the district court in Florida and ultimately to the Eleventh Circuit. *See* Fed. R. Bankr. P. 8002, 9023, 9024. Under the holding of *Celotex*, Spartan Mills cannot allow a final order that deprives it of a lien position to stand and then hope to attack it collaterally at another time and in another forum. Both our circuit and other federal courts have barred bankruptcy parties from collateral assertions of legal claims after they fail, without reason, to object and appeal as required. *See, e.g., First Union Comm. Corp. v. Nelson, Mullins, Riley, and Scarborough (In re Varat Enterprises, Inc.)*, 81 F.3d 1310, 1315 (4th Cir. 1996); *U.S. Dep't of the Air Force v. Carolina Parachute Corp.*, 907 F.2d 1469, 1473-74 (4th Cir. 1990); *Wallis v. Justice Oaks II, Ltd. (In re Justice Oaks, Ltd.)*, 898 F.2d 1544, 1550-52 (11th Cir. 1990); *cf.* 11 U.S.C. § 506(d) ("To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such is void . . . ."); 11 U.S.C. § 1141(a) ("Except [as otherwise provided] . . . the provisions of a confirmed plan bind . . . any creditor . . . ."); 11 U.S.C. § 1327(c) ("Except as otherwise provided in the plan or in the order confirming the plan, the property vesting in the debtor . . . is free and clear of any claim or interest of any creditor provided for by the plan"). As the Supreme Court recently noted in *Celotex*, "It is for the court of first instance to determine the question of the validity of the law, and until its decision is reversed for error by orderly review, either by itself or by a higher court, its orders based on its decision are to be respected." 514 U.S. at ____, 115 S. Ct. at 1501 (quoting *Walker v. Birmingham*, 388 U.S. 307, 314, 87 S. Ct. 1824, 1828, 18 L.Ed.2d 1210 (1967)); *see also Lindsey*, 732 F.2d at 622 (forbidding collateral attack on an erroneous but unappealed bankruptcy order). The lien of a creditor is void if the unappealed, final order of a bankruptcy court vested with proper jurisdiction so

declares regardless of the bankruptcy court's failure to adhere to normal bankruptcy procedures.

While Spartan Mills has agreed that we must apply *Celotex* to the extent it applies in this case, it argues that *Celotex* cannot be applied when the bankruptcy court denied Spartan Mills the notice required by due process.

Due process requires that in order for a proceeding to be accorded finality, notice must be given that is "reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections." *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 314, 70 S. Ct. 652, 657, 94 L.Ed. 865 (1950); *see also Piedmont Trust Bank v. Linkous (In re Linkous)*, 990 F.2d 160, 162-63 (4th Cir. 1993). In this case, Spartan Mills had that notice. During the period when its counsel represented the creditor's committee, the bankruptcy court issued an order proposing to allow Dash Industries to borrow money from Bank of America and, in exchange, to recognize Bank of America's first priority lien in all of Dash Industries' assets, consistent with Bank of America's claim for a first position in its pre-petition lending. The court ordered that persons objecting to Bank of America's first position file an objection or other pleading by a date certain or be barred from challenging its position. The court also ordered the sale of *all* of Dash Industries' assets, free and clear of liens, with distribution of the proceeds to Bank of America in recognition of its first position. And finally the court ratified these acts. Spartan Mills agrees that it received notice of all of these orders. And it surely cannot maintain that the orders failed to advise it that its claimed lien was being subverted. The property in which Spartan Mills had claimed a possessory lien was sold to Cone Mills free and clear of all liens, and the proceeds were distributed by court order to Bank of America in direct conflict with Spartan Mills' first lien claim. Moreover, Spartan Mills' actions in filing an adversary proceeding challenging these rulings and in

negotiating a stipulation with Bank of America to help it maintain its position belie any claimed lack of knowledge.

Rather than object in the Florida bankruptcy court or appeal the bankruptcy court's orders, the record provides ample support for the conclusion that Spartan Mills made a considered decision to try to litigate its lien claim in South Carolina at another time. It pursued an agreement with Bank of America and entered into a stipulation on October 14 which would bar Bank of America from asserting Spartan Mills' lack of possession of Dash Industries' assets as a defense in any subsequent action. It thereafter *voluntarily* dismissed its adversary proceeding filed in the Florida bankruptcy proceeding in the face of a final order that awarded the first lien position to Bank of America. And finally during Spartan Mills' argument before the district court, its counsel stated, "frankly, Spartan preferred to be in a different forum to litigate the lien statute." This is not the case where Spartan Mills was caught by surprise because of a lack of due process notice. Rather, Spartan Mills apparently determined that it would litigate its claim at a different time and in a different court. But in doing so, it left standing final orders that adjudicated its lien claim.

Respect for the orderly process of law demands that the Florida bankruptcy court's final, unappealed order be given effect. *See Celotex*, 514 U.S. at ____, 115 S. Ct. at 1501 (a collateral attack on a bankruptcy order cannot be permitted "without seriously undercutting the orderly process of the law"). Accordingly, the judgment of the district court is

*AFFIRMED.*

## APPENDIX B - ORDER OF THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF SOUTH CAROLINA FILED APRIL 23, 1996

**UNITED STATES DISTRICT COURT**
**FOR THE DISTRICT OF SOUTH CAROLINA**

**Civil Action No. 7:95-1552-21**

**SPARTAN MILLS,**

**Plaintiff,**

**v.**

**BANK OF AMERICA ILLINOIS,**

**Defendant.**

ORDER

The plaintiff, Spartan Mills ("Spartan"), and the defendant, Bank of America Illinois ("BAI"), have filed cross motions for summary judgment pursuant to Rule 56 of the Federal Rules of Civil Procedure. Having carefully considered the arguments presented by both parties, I grant the defendant's motion on the ground that this action constitutes an improper collateral attack on an order entered by the United States Bankruptcy Court for the Southern District of Florida.

### I. FACTUAL BACKGROUND

On May 4, 1993, Dash Industries, Inc. ("Dash"), an apparel manufacturer and distributor, commenced a Chapter 11 bankruptcy proceeding in the United States Bankruptcy Court for the Southern District of Florida. Both Spartan and BAI were creditors of Dash. It is the Florida Bankruptcy Court's order approving the sale of Dash's assets that is the focus of the present controversy.

In its business, Dash created "patterns," which are artistic renderings of fabric designs, and then sent the patterns to Spartan, which in turn utilized them to make "screens." Screens are sheet metal pieces with design perforations that are formed into cylinders and affixed to industrial equipment. The equipment then transfers the pattern into fabric. Spartan created several screens for each pattern and processed fabric for Dash. When Dash filed for bankruptcy on May 4, 1993, it owed Spartan $633,090.37.

On June 11, 1993, the bankruptcy court in Florida entered an order authorizing the debtor-in-possession (Dash) to borrow postpetition, restricting the use of cash collateral, and providing adequate protection ("the DIP Order"). The DIP Order permitted Dash to use BAI's cash collateral during the bankruptcy proceeding. In return for providing Dash with cash collateral, BAI received "a lien against and security interest in all [of Dash's] presently owned and hereafter acquired property, assets, and rights." (Def.'s Mot. for Sum. Judg., Ex. A, DIP Financing Order, paragraph 7). The DIP Order, however, did not contain an adjudication of lien rights. Rather, it provided that any party could file an objection challenging BAI's liens until August 15, 1993:

> [N]othing in this Order shall be deemed to constitute determination by the Court of the validity, priority, or extent of [BAI] or of any person's or entity's prepetition right, title or interest in or to, or lien upon, any of the proceeds of the property or assets of the Debtor except as provided below. Any creditors' committee, creditor, or other party in interest may file a motion or other pleading or before August 15, 1993, challenging (on any ground) the validity or priority of [BAI]'s claims or liens. If no such motion or pleading is filed on or before August 15, 1993, such claims and liens shall be reaffirmed and adopted as a

> finding of this Court and such applications (and any such subsequent applications of cash or other collateral against the [BAI] Pre-Petition Indebtedness) shall no longer be provisional.

(Def.'s Mot. for Sum. Judg., Ex. A, DIP Financing Order, paragraph 12). Spartan Mills did not attempt to challenge the validity or priority of BAI's claims or liens before the August 15, 1993 deadline.

On August 23, 1993, Dash's bankruptcy examiner filed a notice of the sale of Dash's assets. The Bankruptcy Court for the Southern District of Florida entered an order on August 24, 1993 which set the date of the sale as August 30, 1993 and provided that the sale of Dash's assets would be free and clear of all liens, with the liens to attach to the proceeds from the sale. The sale was held on August 30, 1993, and a substantial portion of Dash's assets were sold to Cone Mills for $810,000. The Bankruptcy Court entered a sale order on September 2, 1993 which confirmed that the assets were sold free and clear of all liens, with the liens attaching to the proceeds. The order also provided that the proceeds were to be held in escrow, and the order stated that any objections to the approval of the sale of the assets were required to be filed by September 15, 1993. Spartan did not file an objection to the sale, but Spartan did file a response stating that it claimed first priority in the goods still in its possession.

On September 20, 1993, counsel for Spartan received from counsel for Dash a draft of the "Order Approving Debtor's Sale of Assets to Cone Mills Free and Clear of Liens, with Liens to Attach to Proceeds" ("the Draft Order"). The Draft Order had been prepared by counsel for BAI. Paragraph 29 of the Draft Order stated that the proceeds from the sale would be held in escrow until further order of the Bankruptcy Court. Specifically, paragraph 29 of the Draft Order stated as follows:

> 29. The $810,000 purchase price shall be held by Markowitz, Davis, & Ringel, P.A. in escrow pending the closing of the sale to Cone. The closing of the sale to Cone shall occur on the first business day after this order becomes a final non-appealable order. The $810,000 purchase price shall be held by Markowitz, Davis, & Ringel, P.A., as attorney for the Debtor. in a separate interest-bearing account pending further order of this court.

(Aff. of David H. Conaway, Ex. 5, Draft Order). BAI filed an objection to the Draft Order on September 23, 1993.[1] BAI asserted that it was entitled to the proceeds from the sale of Dash's assets, and wanted the order to be changed to direct that the proceeds be paid to BAI.

The Bankruptcy Court issued the final sale order entitled "Order Approving Debtor's Sale of Assets to Cone Mills Free and Clear of Liens, with Liens to Attach to Proceeds, and Order Granting Debtor's Motion to Assume and Assign Executory Contracts" ("the Sale Order) on September 24, 1993. The Sale Order differed from the Draft Order in that paragraph 30 of the Sale Order effected a payment of the proceeds from the sale to BAI in order to satisfy BAI's lien.[2] Paragraph 30 of the Sale Order replaced Paragraph 29 of the Draft Order, and the language had been changed to state the following:

> 30. The $810,000 purchase price shall be held in escrow by Markowitz, Davis, & Ringel,

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[1]BAI's objection was served on counsel for Spartan Mills.

[2]The Sale Order only required that BAI be paid a sum of the proceeds sufficient to satisfy its lien. However, the proceeds from the sale were not enough th satisfy both BAI's and Spartan's liens, and after BAI was paid, Spartan was left with virtually nothing.

> P.A., pending the closing of the sale to Cone. The closing of the sale to Cone shall occur within three (3) business days after this Order becomes a final, non-appealable order, but in no event later than October 15, 1993. At the closing, Markowitz, Davis, & Ringel, is hereby directed to relinquish to [BAI] that portion of the sale proceeds encumbered by its lien.

(Aff. of David H. Conaway, Ex. 6, Sale Order) (emphasis added).

Spartan was served by mail with a copy of the Sale Order on September 27, 1993. The attorneys for Spartan were not served with a copy of the Sale Order, but they received one from Spartan on October 18, 1993. The proceeds from the sale were paid over to BAI, and the "Notice of Disbursement of Closing Proceeds" was filed with the Bankruptcy Court on or about November 1, 1993. Spartan did not appeal, nor did it challenge in any way, the Sale Order entered by the Bankruptcy Court. In addition, Spartan made absolutely no effort, after the Sale Order was issued, to bring the issue of its lien before the Bankruptcy Court.

On May 31, 1995, Spartan filed this lawsuit in federal court in South Carolina to seek a declaration from this court that § 29-15-70 of the South Carolina Code provides Spartan with a superior lien against the proceeds from the sale of Dash's assets. Spartan also asserts that BAI's acceptance of the proceeds from the sale constituted conversion.

## II. DISCUSSION

### A.

Rule 56(c), Federal Rules of Civil Procedure, states as to a party who has moved for summary judgment:

> The judgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law.

Accordingly, to prevail on a motion for summary judgment, the movant must demonstrate: (1) that there is no genuine issue as to any material fact; and (2) that he is entitled to judgment as a matter of law. As to the first of these determinations, a fact is deemed "material" if proof of its existence or nonexistence would affect the disposition of the case under the applicable law. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986). An issue of such a material fact is "genuine" if the evidence so offered is such that a reasonable jury might return a verdict for the non-movant. *Id.* at 257. In determining whether a genuine issue has been raised, the court must construe all inferences and ambiguities against the movant and in favor of the non-moving party. *United States v. Diebold, Inc.*, 369 U.S. 654, 655 (1962).

The party seeking summary judgment shoulders the initial burden of demonstrating to the district court that there is no genuine issue of material fact. *Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986). Once the movant has made this threshold demonstration, the non-moving party, to survive the motion for summary judgment, may not rest on the allegations averred in his pleadings; rather, he must demonstrate that specific, material facts exist which give rise to a genuine issue. *Id.* at 324. Accordingly, when Rule 56(e) has shifted the burden of proof to the non-movant, he must produce the existence of evidence of every element essential to his action which he bears the burden of adducing at a trial on the merits.

Summary judgment serves the useful purpose of disposing of meretricious, pretended claims before the court

and the parties become entrenched in frivolous litigation. *Donahue v. Windsor Locks Bd. of Fire Comm'rs*, 834 F.2d 54, 58 (2d Cir. 1987). Moreover, although summary judgment is a more extreme remedy, the courts should not be reluctant to grant summary judgment in appropriate cases; indeed, summary judgment is mandated where appropriate. *Herman v. City of Chicago*, 870 F.2d 400, 404 (7th Cir. 1989); *Mieri v. Dacon*, 759 F.2d 989, 998 (2d Cir.), *cert. denied*, 474 U.S. 829 (1985); *United States v. Porter*, 581 F.2d 698, 703 (8th Cir. 1978); *Estate of Detwiler v. Offenbecher*, 728 F. Supp. 103, 134 (S.D.N.Y. 1989); *Burleson v. Illinois Farmers Ins.*, 725 F. Supp. 1489, 1490 (S.D. Ind. 1989). In a recent trilogy of decisions--*Celotex Corp. v. Catrett*, 477 U.S. 317 (1986), *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242 (1986), and *Matsushita Elec. Indus. v. Zenith Radio Corp.*, 475 U.S. 574 (1986)--the Supreme Court has consistently reaffirmed its endorsement of pretrial resolution and summary disposition of baseless actions. These decisions reflect the mandatory nature of Rule 56. In *Celotex Corp. v. Catrett*, 477 U.S. 317 (1986), the Court held:

> The Federal Rules of Civil Procedure have for almost 50 years authorized motions for summary judgment upon proper showings of the lack of a genuine, triable issue of material fact. Summary judgment procedure is properly regarded not as a disfavored procedural shortcut, but rather as an integral part of the Federal Rules as a whole, which are designed to "secure the just, speedy and inexpensive determination of every action." . . . Rule 56 must be construed with due regard not only for the rights of persons asserting claims and defenses that are adequately based in fact to have those claims and defenses tried to a jury, but also for the rights of persons opposing such claims and defenses to demonstrate in the manner provided by the Rule, prior to trial,

> that the claims and defenses have no factual basis.

*Id.* at 327 (citations omitted).

B.

In the Sale Order entered on September 24, 1993, the United States Bankruptcy Court for the Southern District of Florida ordered that a portion of the proceeds from the sale of Dash's assets be relinquished to BAI in order to satisfy its lien. Spartan now comes before this court seeking a declaration that it holds a superior lien against those proceeds and a finding that BAI's receipt of the proceeds constituted conversion.

Spartan asserts that its lien passed through Dash's bankruptcy unaffected because an adversarial proceeding was not instituted to determine the lien's priority. In *Cen-Pen Corp. v. Hanson*, 58 F.3d 89 (4th Cir. 1995), the court stated:

> "Bankruptcy Rule 7001(2) expressly requires initiation of an adversary proceeding 'to determine the validity, priority, or extent of a lien or other interest in property.' . . . The procedural requirements of such an action, which include, inter alia, the filing of a complaint and service of a summons, are set out in the Bankruptcy Rules."

*Id.* at 93 (emphasis in original). Pursuant to the reasoning of the Fourth Circuit in *Cen-Pen*, this court is in agreement with Spartan that an adversarial proceeding was necessary in order to extinguish its lien. No adversarial proceeding was instituted against Spartan in the Florida Bankruptcy Court, and its appears under the law of the Fourth Circuit that Spartan may be correct in its assertion that the Florida Bankruptcy Court erred in ordering the proceeds be paid to BAI without the institution of an action to avoid Spartan's lien. However, in

the opinion of the court, Spartan itself errs in seeking relief in South Carolina from the judgment of the Florida Bankruptcy Court.

Under Bankruptcy Rule 8001(1), Spartan could have appealed the Sale Order to the United States District Court for the Southern District of Florida. Spartan had ten days from the entry of the Sale Order in which to file an appeal, *see* Bankruptcy Rule 8002(a), and Spartan failed to do so. Further, if for some reason Spartan could not file the appeal within the ten day time limit, it could have filed a motion for relief from the Sale Order. Bankruptcy Rule 9024 states that Rule 60(b) of the Federal Rules of Civil Procedure applies in bankruptcy cases. Thus, Spartan could have filed a motion under Rule 60 asserting that the Bankruptcy Court erred in ordering the disbursement of the proceeds to BAI without instituting an adversarial proceeding against Spartan's lien.

Spartan conceded during oral arguments on the cross motions for summary judgment that it was fully aware of its right to appeal and its right to seek relief from the Sale Order. Spartan asserted, however, that it chose not to appeal or file a motion under Rule 60 because it preferred to file a separate action in South Carolina. Unfortunately, this court does not believe that it can decide Spartan's claim on the merits because doing so would constitute a collateral attack on the Sale Order entered by the Florida Bankruptcy Court. The Florida Bankruptcy Court issued an order stating that the proceeds were to be paid to BAI, and this court does not have the authority to order otherwise. *See Celotex Corp. v. Edwards*, 131 L. Ed. 2d 403, 413 (1995) (holding "'it is for the court of first instance to determine the question of the validity of the law, and until its decision is reversed for error by orderly review, either by itself or by a higher court, its orders based on its decision are to be respected'." (quoting *Walker v.*

*Birmingham*, 388 U.S. 307, 314 (1967)));[3] *Lindsey v. Ipock*, 732 F.2d 619, 622 (8th Cir.), *cert. denied*, 469 U.S. 881 (1984) (stating that a bankruptcy order of sale may not be collaterally attacked and must be obeyed if the time for appeal has expired, even if the order was in error); *In re Oyster Bay Cove, Ltd.*, 161 B.R. 338, 342 (Bankr. E.D.N.Y. 1993) (stating that a sale order may not be collaterally attacked; rather it must be challenged by filing an appeal or a motion for relief under Rule 60(b) of the Federal Rules of Civil Procedure).

Spartan would have this court issue an order which would directly contradict the order of the Bankruptcy Court for the Southern District of Florida. This the court is not inclined to do. If Spartan feels the Bankruptcy Court exceeded its jurisdiction or did not accord Spartan due process, then Spartan's remedy lies in Florida and not in South Carolina. Spartan's action constitutes an improper collateral attack on the Sale Order issued by the United States Bankruptcy Court for the Southern District of Florida, and thus, the Sale Order may not be challenged in this forum.

**THEREFORE, IT IS ORDERED** that BAI's motion for summary judgment on the basis that this action constitutes an improper collateral attack be granted, and Spartan's motion for summary judgment be denied.

**IT IS SO ORDERED.**

/S/
William B. Traxler, Jr.
United States District Judge

April 22, 1996

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[3]Spartan argued that the Supreme Court's decision in *Celotex* is limited to injunctions. This court disagrees. The general principles espoused in *Celotex* regarding the impropriety of a collateral attack are applicable to any collateral challenge to an order issued by a court.

## APPENDIX C - ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT FILED JUNE 2, 1997

**SPARTAN MILLS, Plaintiff-Appellant,**

**v.**

**BANK OF AMERICA ILLINOIS,**
**Defendant-Appellee.**

**No. 96-1760.**

United States Court of Appeals,
Fourth Circuit

ORDER
ON PETITION FOR REHEARING WITH
SUGGESTION FOR REHEARING IN BANC

The appellant's petition for rehearing and suggestion for rehearing in banc were submitted to this Court. As no member of this Court or the panel requested a poll on the suggestion for rehearing in banc, and

As the panel considered the petition for rehearing and is of the opinion that it should be denied,

**IT IS ORDERED** that the petition for rehearing and suggestion for rehearing in banc are denied.

For the Court,

/s/ Patricia S. Connor
CLERK

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# APPENDIX D - FULL TEXT OF SELECTED CITED RULES

## Rule 7001 F.R.B.P.
## Scope of Rules of Part VII

An adversary proceeding is governed by the rules of this Part VII. It is a proceeding (1) to recover money or property, except a proceeding to compel the debtor to deliver property to the trustee, or a proceeding under § 554(b) or § 725 of the Code, Rule 2017, or Rule 6002, (2) to determine the validity, priority, or extent of a lien or other interest in property, other than a proceeding under Rule 4003(d), (3) to obtain approval pursuant to § 363(h) for the sale of both the interest of the estate and of a co-owner in property, (4) to object to or revoke a discharge, (5) to revoke an order of confirmation of a chapter 11, chapter 12, or chapter 13 plan, (6) to determine the dischargeability of a debt, (7) to obtain an injunction or other equitable relief, (8) to subordinate any allowed claim or interest, except when subordination is provided in a chapter 9, 11, 12, or 13 plan, (9) to obtain a declaratory judgment relating to any of the foregoing, or (10) to determine a claim or cause of action removed pursuant to 28 U.S.C. § 1452.

## Rule 7004 F.R.B.P.
## Process; Service of Summons, Complaint

(a) Summons; Service; Proof of Service. Rule 4(a), (b), (c)(1), (d)(1), (e)-(j), (l), and (m) F.R.Civ.P. applies in adversary proceedings. Personal service pursuant to Rule 4(e)-(j) F.R.Civ.P. may be made by any person at least 18 years of age who is not a party, and the summons may be delivered by the clerk to any such person.

(b) Service by First Class Mail. Except as provided in subdivision (h), in addition to the methods of

service authorized by Rule 4(e)-(j) F.R.Civ.P., service may be made within the United States by first class mail postage prepaid as follows:

(1) Upon an individual other than an infant or incompetent, by mailing a copy of the summons and complaint to the individual's dwelling house or usual place of abode or to the place where the individual regularly conducts a business or profession.

(2) Upon an infant or incompetent person, by mailing a copy of the summons and complaint to the person upon whom process is prescribed to be served by the law of the state in which service is made when an action is brought against such a defendant in the courts of general jurisdiction of that state. The summons and complaint in that case shall be addressed to the person required to be served at that person's dwelling house or usual place of abode or at the place where the person regularly conducts a business or profession.

(3) Upon a domestic or foreign corporation or upon a partnership or other unincorporated association, by mailing a copy of the summons and complaint to the attention of an officer, a managing or general agent, or to any other agent authorized by appointment or by law to receive service of process and, if the agent is one authorized by statute to receive service and the statute so requires, by also mailing a copy to the defendant.

(4) Upon the United States, by mailing a copy of the summons and complaint addressed to the civil process clerk at the office of the United States attorney for the district in which the action is brought and by mailing a copy of the summons and complaint to the Attorney General of the United States at Washington, District of Columbia, and in any action attacking the validity of an order of an officer or an agency of the United States not made a party, by also mailing a copy of the summons and complaint to that officer or agency. The

court shall allow a reasonable time for service pursuant to this subdivision for the purpose of curing the failure to mail a copy of the summons and complaint to multiple officers, agencies, or corporations of the United States if the plaintiff has mailed a copy of the summons and complaint either to the civil process clerk at the office of the United States attorney or to the Attorney General of the United States.

(5) Upon any officer or agency of the United States, by mailing a copy of the summons and complaint to the United States as prescribed in paragraph (4) of this subdivision and also to the officer or agency. If the agency is a corporation, the mailing shall be as prescribed in paragraph (3) of this subdivision of this rule. The court shall allow a reasonable time for service pursuant to this subdivision for the purpose of curing the failure to mail a copy of the summons and complaint to multiple officers, agencies, or corporations of the United States if the plaintiff has mailed a copy of the summons and complaint either to the civil process clerk at the office of the United States attorney or to the Attorney General of the United States. If the United States trustee is the trustee in the case and service is made upon the United States trustee solely as trustee, service may be made as prescribed in paragraph (10) of this subdivision of this rule.

(6) Upon a state or municipal corporation or other governmental organization thereof subject to suit, by mailing a copy of the summons and complaint to the person or office upon whom process is prescribed to be served by the law of the state in which service is made when an action is brought against such a defendant in the courts of general jurisdiction of that state, or in the absence of the designation of any such person or office by state law, then to the chief executive officer thereof.

(7) Upon a defendant of any class referred to in paragraph (1) or (3) of this subdivision of this rule, it is also sufficient if a copy of the summons and complaint is mailed to

the entity upon whom service is prescribed to be served by any statute of the United States or by the law of the state in which service is made when an action is brought against such a defendant in the court of general jurisdiction of that state.

(8) Upon any defendant, it is also sufficient if a copy of the summons and complaint is mailed to an agent of such defendant authorized by appointment or by law to receive service of process, at the agent's dwelling house or usual place of abode or at the place where the agent regularly carries on a business or profession and, if the authorization so requires, by mailing a copy of the summons and complaint to the defendant as provided in this subdivision.

(9) Upon the debtor, after a petition has been filed by or served upon the debtor and until the case is dismissed or closed, by mailing a copy of the summons and complaint to the debtor at the address shown in the petition or statement of affairs or to such other address as the debtor may designate in a filed writing and, if the debtor is represented by an attorney, to the attorneys at the attorney's post-office address.

(10) Upon the United States trustee, when the United States trustee is the trustee in the case and service is made upon the United States trustee solely as trustee, by mailing a copy of the summons and complaint to an office of the United States trustee or another place designated by the United States trustee in the district where the case under the Code is pending.

(c) Service by Publication. If a party to an adversary proceeding to determine or protect rights in property in the custody of the court cannot be served as provided in Rule 4(e)-(j) F.R.Civ.P. or subdivision (b) of this rule, the court may order the summons and complaint to be served by mailing copies thereof by first class mail, postage prepaid, to the party's last known address, and by at least one publication in such manner and form as the court may direct.

(d) Nationwide Service of Process. The summons and complaint and all other process except a subpoena may be served anywhere in the United States.

(e) Summons: Time Limit for Service. If service is made pursuant to Rule 4(e)-(j) F.R.Civ.P. it shall be made by delivery of the summons and complaint within 10 days following the issuance of the summons. If service is made by any authorized form of mail, the summons and complaint shall be deposited in the mail within 10 days following issuance of the summons. If a summons is not timely delivered or mailed, another summons shall be issued and served.

(f) Personal Jurisdiction. If the exercise of jurisdiction is consistent with the Constitution and laws of the United States, serving a summons or filing a waiver of service in accordance with this rule or the subdivisions of Rule 4 F.R.Civ.P. made applicable by these rules is effective to establish personal jurisdiction over the person of any defendant with respect to a case under the Code or a civil proceeding arising under the Code, or arising in or related to a case under the Code.

(g) [Abrogated]

(h) Service of Process on an Insured Depository Institution. Service on an insured depository institution (as defined in section 3 of the Federal Deposit Insurance Act) in a contested matter or adversary proceeding shall be made by certified mail addressed to an officer of the institution unless --

(1) the institution has appeared by its attorney, in which case the attorney shall be served by first class mail;

(2) the court orders otherwise after service upon the institution by certified mail of notice of an application to permit service on the institution by first class mail sent to an officer of the institution designated by the institution; or

(3) the institution has waived in writing its entitlement to service by certified mail by designating an officer to receive service.

Rule 4 F.R.Civ.P.
Summons

(a) Form. The summons shall be signed by the clerk, bear the seal of the court, identify the court and the parties, be directed to the defendant, and state the name and address of the plaintiff's attorney or, if unrepresented, of the plaintiff. It shall also state the time within which the defendant must appear and defend, and notify the defendant that failure to do so will result in a judgement by default against the defendant for the relief demanded in the complaint. The court may allow a summons to be amended.

(b) Issuance. Upon or after filing the complaint, the plaintiff may present a summons to the clerk for signature and seal. If the summons is in proper form, the clerk shall sign, seal, and issue it to the plaintiff for service on the defendant. A summons, or a copy of the summons if addressed to multiple defendants, shall be issued for each defendant to be served.

(c) Service with Complaint; by Whom Made

(1) A summons shall be served together with a copy of the complaint. The plaintiff is responsible for service of a summons and complaint within the time allowed under subdivision (m) and shall furnish the person effecting service with the necessary copies of the summons and complaint.

(2) [Not applicable.]

(d) Waiver of Service; Duty to Save Costs of Service; Request to Waive.

(1) A defendant who waives service of a summons does not thereby waive any objection to the venue or to the jurisdiction of the court over the person of the defendant.

(2) [Not applicable.]

(3) [Not applicable.]

(4) [Not applicable.]

(5) [Not applicable.]

(e) Service Upon Individuals Within a Judicial District of the United States. Unless otherwise provided by federal law, service upon an individual from whom a waiver has not been obtained and filed, other than an infant or an incompetent person, may be effected in any judicial district of the United States:

(1) pursuant to the law of the state in which the district court is located, or in which service is effected, for the service of a summons upon the defendant in an action brought in the courts of general jurisdiction of the State; or

(2) by delivering a copy of the summons and of the complaint to the individual personally or by leaving copies thereof at the individual's dwelling house or usual place of abode with some person of suitable age and discretion then residing therein or by delivering a copy of the summons and of the complaint to an agent authorized by appointment or by law to receive service of process.

(f) Service upon Individuals in a Foreign Country. Unless otherwise provided by federal law, service upon an individual from whom a waiver has not been obtained other than an infant or an incompetent person, may be effected in a place not within any judicial district of the United States:

(1) by any internationally agreed means reasonably calculated to give notice, such as those means authorized by the Hague Convention on the Service Abroad of Judicial and Extrajudicial Documents; or

(2) if there is no internationally agreed means of service or the applicable international agreement allows other means of service, provided that service is reasonably calculated to give notice:

(A) in the manner prescribed by the law of the foreign country for service in that country in an action in any of its courts of general jurisdiction; or

(B) as directed by the foreign authority in response to a letter rogatory or letter of request; or

(C) unless prohibited by the law of the foreign country, by

(i) delivery to the individual personally of a copy of the summons and the complaint; or

(ii) any form of mail requiring a signed receipt, to be addressed and dispatched by the clerk of the court to the party to be served; or

(3) by other means not prohibited by international agreement as may be directed by the court.

(g) Service Upon Infants and Incompetent Persons. Service upon an infant or an incompetent person in a judicial district of the United States shall be effected in the manner prescribed by the law of the state in which the service is made for the service of summons or other like process upon any such defendant in an action brought in the courts of general jurisdiction of that state. Service upon an infant or an incompetent person in a place not within any judicial district

of the United States shall be effected in the manner prescribed by paragraph (2)(A) or (2)(B) of subdivision (f) or by such means as the court may direct.

(h) Service Upon Corporations and Associations. Unless otherwise provided by federal law, service upon a domestic or foreign corporation or upon a partnership or other unincorporated association that is subject to suit under a common name, and from which a waiver of service has not been obtained and filed, shall be effected:

(1) in a judicial district of the United States in the manner prescribed for individuals by subdivision (e)(1), or by delivering a copy of the summons and of the complaint to an officer, a managing or general agent, or to any other agent authorized by appointment or by law to receive service of process and, if the agent is one authorized by statute to receive service and the statute so requires, by also mailing a copy to the defendant, or

(2) in a place not within any judicial district of the United States in any manner prescribed for individuals by subdivision (f) except personal delivery as provided in paragraph (2)(C)(i) thereof.

(i) Service Upon the United States, and Its Agencies, Corporations, or Officers.

(1) Service upon the United States shall be effected

(A) by delivering a copy of the summons and of the complaint to the United States attorney for the district in which the action is brought or to an assistant United States attorney or clerical employee designated by the United States attorney in a writing filed with the clerk of the court or by sending a copy of the summons and of the complaint by registered or certified mail addressed to the civil process clerk at the office of the United States attorney and

(B) by also sending a copy of the summons and of the complaint by registered or certified mail to the Attorney General of the United States at Washington, District of Columbia, and

(C) in any action attacking the validity of an order of an officer or agency of the United States not made a party, by also sending a copy of the summons and of the complaint by registered or certified mail to the officer or agency.

(2) Service upon an officer, agency, or corporation of the United States shall be effected by serving the United States in the manner prescribed by paragraph (1) of this subdivision and by also sending a copy of the summons and of the complaint by registered or certified mail to the officer, agency, or corporation.

(3) The court shall allow a reasonable time for service of process under this subdivision for the purpose of curing the failure to serve multiple officers, agencies, or corporations of the United States if the plaintiff has effected service on either the United States attorney, or the Attorney General of the United States.

(j) Service Upon Foreign, State, or Local Governments.

(1) Service upon a foreign state or a political subdivision, agency, or instrumentality thereof shall be effected pursuant to 28 U.S.C. § 1608.

(2) Service upon a state, municipal corporation, or other governmental organization subject to suit shall be effected by delivering a copy of the summons and of the complaint to its chief executive officer or by serving the summons and complaint in the manner prescribed by the law

of that state for the service of summons or other like process upon any such defendant.

(k) [Not applicable]

(l) Proof of Service. If service is not waived, the person effecting service shall make proof thereof to the court. If service is made by a person other than a United States marshal or deputy United States marshal, the person shall make affidavit thereof. Proof of service in a place not within any judicial district of the United States shall, if effected under paragraph (1) of subdivision (f), be made pursuant to the applicable treaty or convention, and shall, if effected under paragraph (2) or (3) thereof, include a receipt signed by the addressee or other evidence of delivery to the addressee satisfactory to the court. Failure to make proof of service does not affect the validity of the service. The court may allow proof of service to be amended.

(m) Time Limit for Service. If service of the summons and complaint is not made upon a defendant within 120 days after the filing of the complaint, the court, upon motion or on its own initiative after notice to the plaintiff, shall dismiss the action without prejudice as to that defendant or direct that service be effected within a specified time; provided that if the plaintiff shows good cause for the failure, the court shall extend the time for service for an appropriate period. This subdivision does not apply to service in a foreign country pursuant to subdivision (f) or (j)(1).

(n) [Not applicable]